The Economist Intelligence Unit

Global risk hotspots:
an EIU assessment

A special report from The Economist Intelligence Unit

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Introduction

Now, more than ever, financial institutions require authoritative and trusted assessments of credit risk to pursue profitable opportunities in challenging markets. This report provides a snapshot of some of the capabilities of The Economist Intelligence Unit's (The EIU's) risk assessment services. It analyses risk scenarios in depth, to help you understand and respond to risks that could impact your business. The EIU can help you assess and compare cross-border credit and financial risk in 128 markets worldwide. Our Country Risk Service provides in-depth ratings enables you to swiftly identify countries which are experiencing a deterioration or improvement in creditworthiness and to rank countries in order of riskiness, it's a valuable tool to help your organisation to optimise its country credit limits.

The following articles look at some of the main risk-rating categories (sovereign, currency, banking, politics and economic structure) to provide a snapshot of the analysis, including any grade changes, positive and negative factors, and the risk-rating outlook over the next twelve months.

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Brazil

Sovereign risk

	Rating
January 2015	BB
Robert Wood (lead analyst); Irene Mia (analyst). Published 23 January 2015, 2100 GMT.	
The ratings contained in this report and the report itself were produced outside the European Union and therefore are not issued by The Economist Intelligence Unit credit rating agency, which is registered in accordance with Regulation (EC) No 1060/2009 of 16 September 2009, on credit rating agencies, as amended. This report and the ratings, therefore, are not issued pursuant to such Regulation and do not fall within its scope.	

Current assessment

The deterioration of key macroeconomic and financial indicators in Brazil since The Economist Intelligence Unit's last main report in September has caused a worsening of 4 points in the underlying score, triggering a downgrade in the sovereign rating from BBB (our investment grade) to the BB band. An expansionary stance in 2014 (an election year) has eroded the primary fiscal balance, reaching a deficit of 0.2% of GDP in the 12 months to November, while debt interest payments reached 5.6% of GDP, reflecting higher interest rates. Together with virtually flat GDP growth, this has lifted the gross public debt/GDP ratio to an estimated 63.7% currently, above a key benchmark (60%) in our model. Weaker export commodity prices and a fall in manufacturing exports to Argentina have lifted the current-account deficit to 4% of GDP, another benchmark in our model, which has triggered a deterioration in several financial indicators. Despite the downgrade to BB, Brazil still has important structural strengths, including a large reserves cushion—US$373bn at the beginning of January, according to the Banco Central do Brasil (BCB, the Central Bank)—low external public debt, a solid tax base and deep capital markets.

Positive factors

Federal government debt is well structured: last November fixed-rate debt accounted for 40.8%; inflation-linked debt for 35.4%; floating-rate debt for 18.9%; and 4.9% was denominated in foreign currency. The average term to maturity of federal government debt is over six and a half years.

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Negative factors

A new policy-tightening cycle that began in October 2014 has lifted interest rates, to 11.75% currently, with further tightening expected. Debt interest payments are already high (5.6% of GDP in November).

Rating outlook

Although we recognise that the appointment of an orthodox finance minister, Joaquim Levy, will help to improve the quality of policymaking, lifting the primary surplus to the new targets of 1.2% of GDP in 2015 and 2% of GDP in 2016 will prove challenging in a context of a weak local economy and testing global conditions. Mr Levy's own commitment to disciplined fiscal policies is unquestioned, but there is considerable uncertainty regarding how long the president, Dilma Rousseff, will persist with austerity, given that her popularity will suffer from spending cuts and tax rises. Reversing the deterioration in macroeconomic indicators that has contributed to Brazil's downgrade to BB in our model will take some time. Nonetheless, Brazil will still have few difficulties in meeting its debt obligations. According to the latest government data (for November 2014), federal government debt falling due in 2015 amounts to R454bn (US$168bn), or 21.6% of the total.

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Russia

Currency risk

	Rating
February 2015	BB

Current assessment

The Russian rouble was one of the worst-performing currencies in 2014. Following sharp falls in late November and December, the rouble was down by more than 40% year on year at the end of 2014. A number of factors have driven the devaluation of the currency. The conflict in Ukraine has heightened investors' perceptions of political risk, and has accelerated capital flight; meanwhile, Western sanctions have, in effect, closed access to international financial markets, making it impossible for companies to roll over existing debt. Finally, and most decisively, the fall in the oil price, which declined from over US$110/b in June 2014 to under US$60/b at the end of the year, has cut export revenue and further weakened investor sentiment. The Russian Central Bank (RCB) has allowed the rouble to devalue in order to facilitate external adjustment and conserve reserves. It nevertheless spent around US$80bn last year in an effort to support the currency. On December 16th the RCB raised interest rates by 650 basis points in an effort to stabilise the currency, but this appeared only to spook the market. With confidence in the rouble and the RCB very low, it may only take a small shift in sentiment—as a result, for example, of further falls in the oil price, a tightening of Western sanctions, or a ratings downgrade—to trigger another round of currency volatility. Despite the RCB's commitment to a floating exchange rate, further falls in the rouble could pose a serious risk to financial stability, and may therefore lead to further foreign-exchange intervention by the central bank.

Source: The Economist Intelligence Unit.

Positive factors

The devaluation of the currency will lead to a sharp fall in imports, which is likely to keep the current account in surplus and so conserve foreign reserves.

Despite high capital outflows, the authorities have rejected capital controls, which are only likely to be used as a last resort.

Negative factors

A surge in violence in eastern Ukraine could lead to a tightening of US and EU sanctions, which would further increase capital outflows and put downward pressure on the currency.

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The RCB's decision to loosen collateral criteria for foreign-currency repo operations may have weakened confidence in the central bank.

Rating outlook

The rouble may weaken further in the first half of the year, as capital outflows will remain high. We expect oil prices to recover from their current level over the year, which may lead to a strengthening of the currency, particularly if, as we currently forecast, the EU's sectoral sanctions are eased in July. However, a further escalation of violence in Ukraine or sovereign risk rating downgrade by a second major ratings agency would likely lead to further currency volatility.

Foreign-exchange regime

The RCB has moved to a currency free float. However, further depreciation represents a risk to financial stability. As a result, the RCB is likely to continue interventions to support the currency and prevent volatility in 2015.

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Greece

Sovereign risk

	Rating
February 2015	CCC
Joan Hoey (lead analyst); Robert O'Daly (analyst). Published 20 February 2015, 2100 GMT.	
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There is no change in the rating band compared with October 2014, but there has been a six-point deterioration in Greece's score, taking it to the upper limits of the CCC band. Market uncertainty has increased significantly since the left-wing Syriza-led government came to power following the January 25th pre-term 2015 election, repudiating the bailout programme and demanding debt restructuring.

Rating outlook

Greece's sovereign rating is under immense pressure because of the new government's refusal to countenance a continuation of the second economic adjustment ("bailout") programme and the demand for a restructuring of its debt. The government's confrontational approach during its first weeks in office has brought it to the brink of a breakdown in relations with the country's external creditors. Unless a compromise agreement is reached in the coming weeks, Greece's ability to finance its debt payments will be in question.

The Economist Intelligence Unit's sovereign rating indicates a high probability of default or restructuring; our baseline forecast is that Greece will agree a new reform programme in the coming months and receive further debt relief, probably in the form of longer maturities and/or cuts in interest rates.

At the equivalent of an estimated 173% of GDP at end-2014, Greece's public debt poses obvious financing concerns. These have been mitigated until now by government's adherence to the country's €240bn EU/IMF bailout programme, and by the low cost and long maturities of the official credit being extended. However, the EU portion of the bailout programme expires at the end of February 2015 (the programme having been extended from the end of 2014), and the prime minister, Alexis Tsipras, insists that his government will not agree to a further extension and will not accept a continuation of the monitoring regime under the "Troika" of the ECB, the European Commission and the IMF.

We do not envisage an upgrade of Greece's sovereign rating in the short term, especially as it is at the risky end of the CCC rating band. On the contrary, there is a possibility of a further downgrade for several reasons. Even if an agreement is reached in line with our baseline forecast, the risk that it will run into political trouble at a later date is considerable. If negotiations between Greece and its creditors are protracted, the risk of a bank run will rise, raising the spectre of capital controls and Greece's effective

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Italy

Risk Assessment

	Sovereign risk	Currency risk	Banking sector risk	Political risk	Economic structure risk	Country risk
February 2015	BB	BB	BBB	BB	BB	BB
Robert O'Daly (lead analyst); Aengus Collins (analyst). Published 06 February 2015, 2100 GMT.						
This sovereign rating is issued by The Economist Intelligence Unit credit rating agency, registered in accordance with Regulation (EC) No 1060/2009 of 16 September 2009, on credit rating agencies, as amended, and is issued pursuant to such regulation.						

Sovereign risk

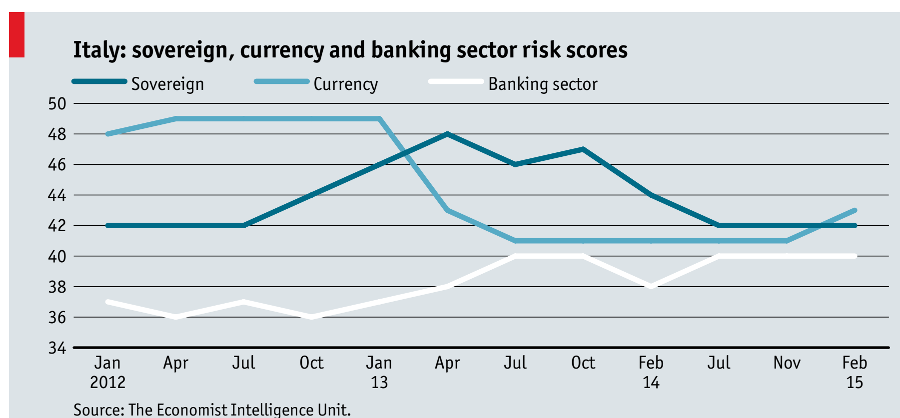
A prolonged recession and low inflation will make it difficult to halt the rise of Italy's public debt/GDP ratio, which The Economist Intelligence Unit expects to reach 136% in 2015. The weakness of the economy will constrain revenue and curtail ambitious plans to cut spending. We expect the deficit to remain around 3% of GDP, but the primary surplus will shrink to 1.1% of GDP from an estimated 1.4% in 2014.

Currency risk

The depreciation of the euro against the US dollar has been sharp since mid-2014. With economic growth and monetary policy diverging sharply in the euro zone and the US, we expect continued weakness of the euro in 2015 and 2016. The risk of one or more countries leaving the euro zone is edging up amid prolonged economic sluggishness across the bloc and intensifying concerns about political instability in Greece.

Banking sector risk

Non-performing loans have risen rapidly, which has undermined already weak profitability and forced several Italian banks to plug large capital shortfalls. EUwide stress tests in October 2014 exposed the



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weaknesses of the Italian banking system, leaving them vulnerable to a renewed loss of confidence. Their large holdings of Italian government debt are also a source of vulnerability.

Political risk

The broad coalition formed by Matteo Renzi in February 2014 is fragile. If his bold push to reform the electoral system and streamline the institutions fails, then the next general election could lead to greater political fragmentation.

Economic structure risk

Italy's net external asset position (-28.8% of GDP) is less weak than those of other euro zone peripheral states, and the current account has moved into a small surplus. But economic growth prospects are poor owing to weak competitiveness. Italy has made little progress in reducing high unit labour costs and Italian firms produce mostly medium- rather than high-technology goods.

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Conclusion

In a financial services environment with ever-evolving regulations, it is important to remain up-to-date on how best to evaluate and assess cross-border credit and financial risks. These articles provide an analytical insight on how your business can effectively monitor emerging and developed markets on a continuous basis, helping you to answer questions of vital importance for decision-making and economic outcomes for your business. The EIU's Country Risk Service helps you to put a variety of financial risks into context, delivering timely and relevant analysis on issues facing your organisation in a constantly changing business environment.

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Product Page

Now, more than ever, financial institutions and companies require authoritative and trusted assessments of credit risk to pursue profitable opportunities in difficult markets. The information in this report is a snapshot of the services available through The EIU's Country Risk Service.

The Country Risk Service provides risk ratings and analysis for 128 countries worldwide, monitoring both emerging and developed markets on a continuous basis. Each Country Risk Service report includes a one-page summary, covering the five main rating categories (sovereign, currency, banking, politics and economic structure). Comprehensive analysis and explanation of the ratings, including any grade changes, positive and negative factors, and the ratings outlook over the next twelve months accompany each report.

The service enables access to updated two-year forecasts for the economic variables that are most important for risk assessment; presenting data consistently across all reports allows you to make easy country-by-country comparisons. The Country Risk Service is based on quantitative and qualitative indicators to assess six different categories of risk, helping you answer vital business questions that influence important decision-making and economic outcomes for your organisation.

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